

Board Approved -9-15-09

HIGHLANDS STATE BANK CORPORATE GOVERNANCE GUIDELINES

The Board of Directors (the “Board”) of Highlands State Bank (the “Bank”) has adopted the following Corporate Governance Guidelines (the “Guidelines”) to assist the Board in the exercise of its duties and responsibilities and to serve the best interests of the Bank and its stockholders. The Guidelines should be applied in a manner consistent with all applicable laws and the Bank’s charter and bylaws, each as amended and in effect from time to time. The Guidelines provide a framework for the conduct of the Board’s business. The Board may modify or make exceptions to the Guidelines from time to time in its discretion and consistent with its duties and responsibilities to the Bank and its stockholders.

A. Director Responsibilities

1. Oversee Management of the Bank. The principal responsibility of the Directors’ is to oversee the management of the Bank and, in so doing, serve the best interests of the Bank and its stockholders. This responsibility includes:

- Reviewing and approving fundamental operating, financial and other corporate plans, strategies and objectives.
- Evaluating the performance of the Bank and its senior executives and taking appropriate action, including removal, when warranted.
- Requiring, approving and implementing senior executive succession plans.
- Establishing a corporate environment that promotes timely and effective disclosure (including robust and appropriate controls, procedures and incentives), fiscal accountability, high ethical standards and compliance with all applicable laws and regulations.
- Developing a corporate governance structure that allows and encourages the Board to fulfill its responsibilities.
- Providing advice and assistance to the Bank’s senior executives.
- Evaluating the overall effectiveness of the Board and its committees.

2. Exercise Business Judgment. In discharging their fiduciary duties of care, loyalty and candor, directors are expected to exercise their business judgment to act in what they reasonably believe to be the best interests of the Bank and its stockholders. 3. Understand the Bank and its Business. Directors have an obligation to become and remain informed about the Bank and its business, including the following:

- The principal operational and financial objectives, strategies and plans of the Bank.

- significant subsidiaries and business segments.
- The relative standing of the business segments within the Bank and vis-à-vis competitors.
- The factors that determine the Bank's success.
- The risks and problems that affect the Bank's business and prospects.

4. Establish Effective Systems. Directors are responsible for determining that effective systems are in place for the periodic and timely reporting to the Board on important matters concerning the Bank, including the following:

- Current business and financial performance, the degree of achievement of approved objectives and the need to address forward-planning issues.
- Future business prospects and forecasts, including actions, facilities, personnel and financial resources required to achieve forecasted results.
- Financial statements, with appropriate segment or divisional breakdowns.
- Adoption, implementation and monitoring of effective compliance programs to assure the Bank's compliance with law and corporate policies.
- Material litigation and governmental and regulatory matters.
- Directors should also periodically review the integrity of the Bank's internal control and management information systems.

5. Board and Committee Meetings. Directors are responsible for attending Board meetings and meetings of committees on which they serve, and devoting the time needed, and meeting as frequently as necessary, to discharge their responsibilities properly.

6. Reliance on Management and Advisors; Indemnification. The directors are entitled to rely on the Bank's senior executives and its outside advisors, auditors and legal counsel, except to the extent that any such person's integrity, honesty or competence is in doubt. The directors are also entitled to Bank-provided indemnification, statutory exculpation and directors' and officers' liability insurance.

B. Director Qualification Standards

1. Independence. A majority of the members of the Board shall be independent directors. To be considered independent: (1) a director must be independent as determined under NASD Rule 4200(a)(15) and any successor thereto and (2) in the Board's judgment, the director must not have a relationship which would interfere with the exercise of the director's independent judgment in carrying out the director's duties as a member of the Board.

Ownership of a significant amount of the Bank's stock, by itself, does not constitute a material relationship.

2. Other Directorships. A director shall limit the number of other public Bank boards on which he or she serves so that he or she is able to devote adequate time to his or her duties to the Bank, including preparing for and attending meetings. Service on boards and/or committees of other organizations shall comply with the Bank's conflict of interest policies.

3. Tenure. The Board does not believe it should establish term limits. Term limits could result in the loss of directors who have been able to develop, over a period of time, increasing insight into the Bank and its operations and an institutional memory that benefit the entire membership of the Board as well as management. As an alternative to term limits, the Nominating Committee shall review each director's continuation on the Board at least once every three (3) years. This will allow each director the opportunity to conveniently confirm his or her desire to continue as a member of the Board and allow the Bank to conveniently replace directors who are no longer interested or effective.

4. Retirement. No Director shall be eligible for nomination subsequent to his or her seventy fifth (75th) birthday.

5. Selection of New Director Candidates. The Nominating Committee shall be responsible for identifying, evaluating and recommending candidates to become members of the Board with the goal of creating a balance of knowledge, experience and interest. Nominations, other than those made by the Nominating Committee, shall be made in writing and shall be delivered or mailed to the President in accordance with Section 2.1 of Article II of the Bank's bylaws. Candidates are reviewed in the context of current composition of the Board, the operating requirements of the Bank and the long-term interests of the Bank's stockholders and are evaluated for their character, judgment, business experience and acumen. In conducting this assessment, the Committee will consider and evaluate director-candidates based upon the following factors:

- (a) Whether the candidate qualifies as "independent" in accordance with the standards set forth in paragraph 1 above.
- (b) Whether the candidate has an ability to bring on-going business to the Bank.

- (c) Candidates should be accomplished in their respective fields and have reputations, both personal and professional, that are consistent with the image and reputation of the Bank.
- (d) Candidates should be ethical individuals of proven judgment and competence, possessing professional experience and skills that are complementary to the needs of the Bank.
- (e) Candidates should have an ability to read and understand basic financial statements. The Nominating Committee will also determine if any of the candidates satisfy the criteria for being and “audit committee financial expert” as defined by the Securities and Exchange Commission.
- (g) Candidates should have knowledge of the Bank and issues affecting the Bank.
- (h) Candidates should be committed to enhancing stockholder value.
- (i) Candidates should understand, or have the capacity to understand, fully the legal responsibilities of a director and the governance processes of a public Bank.
- (j) Candidates should have demonstrated the ability and be willing to apply sound, objective and independent business judgment, and to assume broad fiduciary responsibility.
- (k) Candidates should be willing to devote sufficient time to fulfill their obligations to the Bank and its stockholders.
- (l) Candidates should not have any prohibitive interlocking relationships or conflicts of interest.
- (m) Candidates should be able to develop a good working relationship with other Board members and contribute to the Board’s working relationship with the senior management of the Bank.
- (n) Candidates may not be under indictment for, or have ever been convicted of, a criminal offense involving dishonesty or breach of trust and the penalty for such offense could be imprisonment for more than one year.
- (o) Candidates may not have been someone against whom a federal or state ban regulatory agency has issued a cease and desist order for conduct involving dishonesty or breach of trust and that order is final and not subject to appeal.
- (p) Candidates may not have been found either by any federal or state regulatory agency whose decision is final and not subject to appeal or by a court to have (i) breached a fiduciary duty involving personal profit or (ii) committed a willful violation of any law, rule or regulation governing banking, securities, commodities or insurance, or any final cease and desist order issued by a banking, securities, commodities or insurance regulatory agency.
- (q) Candidates may not have been nominated by a person (or an affiliate of a person) who would be disqualified from serving as director for any of the reasons set forth in subsections (n), (o) or (p) above.

- (r) Candidates may not be a party (either directly or through an affiliate) to litigation or an administrative proceeding adverse to the Bank except (i) derivative litigation brought in the name of the Bank by the director in his or her capacity as a shareholder of the Bank or (ii) litigation arising out of any proxy fight concerning the election of directors of the Bank or otherwise involving control of the Bank.

C. Board Meetings

- 1. Selection of Agenda Items. The Chairman of the Board shall establish the agenda for each Board meeting. Each Board member is free to suggest the inclusion of agenda items and is free to raise at any Board meeting subjects that are not on the agenda for that meeting. During at least one meeting each year, the Board shall review the Bank's long-term strategic plans and the principal issues that the Bank expects to confront in the future.
- 2. Frequency and Length of Meetings. The Chairman of the Board, in consultation with the members of the Board, shall determine the frequency and length of the Board meetings. Special meetings may be called from time to time as determined by the needs of the business and in accordance with the Bank's bylaws.
- 3. Advance Distribution of Materials. Information and data that are important to the Board's understanding of the business to be conducted at a Board or committee meeting should generally be distributed in writing to the directors before the meeting, and directors should review these materials in advance of the meeting. The Board acknowledges that certain items to be discussed at a Board or committee meeting may be of an extremely confidential or time-sensitive nature and that the distribution of materials on these matters prior to meetings may not be appropriate or practicable. Presentations made at Board meetings should do more than summarize previously distributed Board meeting materials.
- 4. Executive Sessions. The independent directors shall meet in executive session at least semi-annually to discuss, among other matters, the performance of the Chief Executive Officer. The independent directors will meet in executive session at other times at the request of any non-management director. Absent unusual circumstances, these sessions shall be held in conjunction with regular Board meetings. The director who presides at these meetings shall be the Chairman of the Board of Directors..

D. Board Committees

- 1. Key Committees. The Board shall have at all times an Audit Committee, a Compensation Committee and a Nominating Committee. Each such committee shall have a charter that has been approved by the Board. The Board may, from time to time, establish or maintain additional committees as necessary or appropriate.

2. Committee Charters. In accordance with the applicable rules of the NASDAQ, the charters of the Audit Committee, the Compensation Committee, the Nominating Committee, and any other additional committee established or maintained by the Board, shall set forth the purposes, goals and responsibilities of the committees as well as qualifications for committee membership, procedures for committee member appointment and removal, committee structure and operations and committee reporting to the Board. The Board shall, from time to time as it deems appropriate, review and reassess the adequacy of each charter and make appropriate changes. Such charters shall be posted, in their most current versions, on the Bank's website

E. Director Access to Management and Independent Advisors

1. Access to Officers and Employees. Directors have full and free access to officers and employees of the Bank. Any meetings or contacts that a director wishes to initiate may be arranged through the Chief Executive Officer. The directors shall use their judgment to ensure that any such contact is not disruptive to the business operations of the Bank and shall, to the extent appropriate, copy the Chief Executive Officer on any written communications between a director and an officer or employee of the Bank.
2. Access to Independent Advisors. The Board, and to the extent provided for in its charter, certain committees, have the power to hire and consult with independent legal, financial or other advisors for the benefit of the Board or such committee, as they may deem necessary, without consulting or obtaining the approval of any officer of the Bank in advance. Such independent advisors may be the regular advisors to the Bank. The Board or any such committee is empowered, without further action by the Bank, to cause the Bank to pay the compensation of such advisors as established by the Board or any such committee.

E. Director Compensation

1. Role of Board and Nominating Committee. The form and amount of director compensation shall be determined by the Board in accordance with the policies and principles set forth below. The Nominating Committee shall conduct an annual review of the compensation of the Bank's directors. The Nominating Committee shall consider that questions as to directors' independence may be raised if director compensation and perquisites exceed customary levels, if the Bank makes substantial charitable contributions to organizations with which a director is affiliated or if the Bank enters into consulting contracts or business arrangements with (or provides other indirect forms of compensation to) a director or an organization with which the director is affiliated.
2. Form of Compensation. The Board believes that directors should be incentivized to focus on long-term stockholder value. Including equity as part of director compensation helps align the interest of directors with those of the Bank's stockholders.

3. Amount of Consideration. The Bank seeks to attract exceptional talent to its Board. Therefore, the Bank's policy is to compensate directors at least competitively relative to comparable companies. The Bank's management shall, from time to time, present a comparison report to the Board, comparing the Bank's director compensation with that of comparable companies. The Board believes that it is appropriate for the Chairman of the Board and the chairmen and members of the committees to receive additional compensation for their services in those positions.
4. Employee Directors. Directors who are also employees of the Bank shall receive no additional compensation for Board or committee service.

G. Director Orientation and Continuing Education

1. Director Orientation. The Board and the Bank's management shall conduct a mandatory orientation program for new directors. The orientation program shall include presentations by management to familiarize new directors with the Bank's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its code of business conduct and ethics, its principal officers, its internal and independent auditors and its outside legal advisors. In addition, the orientation program shall include a review of the Bank's expectations of its directors in terms of time and effort and a review of the directors' fiduciary duties. All other directors are also invited to attend the orientation program.
2. Continuing Education. Each director is expected to be involved in continuing director education on an ongoing basis to enable him or her to better perform his or her duties and to recognize and deal appropriately with issues that arise. The Bank shall pay all reasonable expenses related to continuing director education.

H Management Evaluation and Succession

1. Selection of Chief Executive Officer. The Board selects the Bank's Chief Executive Officer in the manner that it determines to be in the best interests of the Bank's stockholders.
2. Evaluation of Senior Executives. The Nominating Committee shall be responsible for overseeing the evaluation of the Bank's senior executives. In conjunction with the Audit Committee, in the case of the evaluation of the senior financial executives, the Nominating Committee shall determine the nature and frequency of the evaluation and the persons subject to the evaluation, supervise the conduct of the evaluation and prepare assessments of the performance of the Bank's senior executives, to be discussed with the Board periodically. The Board shall review the assessments to ensure that the senior executives are providing the best leadership for the Bank over both the long- and short-term.

3. Succession of Senior Executives. The Nominating Committee shall present an annual report to the Board on succession planning, which shall include transitional Board leadership in the event of an unplanned vacancy. The entire Board shall assist the Committee in finding and evaluating potential successors to the Chief Executive Officer and the Chief Financial Officer. The Chief Executive Officer and the Chief Financial Officer should at all times make available his or her recommendations and evaluations of potential successors, along with a review of any development plans recommended for such individuals. The Committee shall identify, and periodically review and reassess, the qualities and characteristics necessary for an effective Chief Executive Officer and Chief Financial Officer. With these principles in mind, the Committee should periodically monitor and review the development and progression of potential internal candidates against these standards.

I. Annual Performance Evaluation of the Board

The Nominating Committee shall oversee an annual self-evaluation of the Board to determine whether it and its committees are functioning effectively. The Nominating Committee shall determine the nature of the evaluation, supervise the conduct of the evaluation and prepare an assessment of the Board's performance, to be discussed with the Board. To assist in its self-assessment, the Board shall, at the beginning of each year, consider establishing an agreed-upon list of Board objectives and performance goals for the year, which shall be used as benchmarks in evaluating its performance at year end. The purpose of this process is to improve the effectiveness of the Board and its committees and not to target individual Board members.

J. Board Interaction with Institutional Investors, the Press, Customers, Etc.

The Board believes that the Chief Executive Officer and his or her designees speak for the Bank. Individual Board members may, from time to time, meet or otherwise communicate with various constituencies that are involved with the Bank. It is, however, expected that Board members would do so with the knowledge of and, absent unusual circumstances or as contemplated by the committee charters, only at the request of the Bank's senior executives.

K. Periodic Review of the Corporate Governance Guidelines

The Nominating Committee shall, from time to time as it deems appropriate, review and reassess the adequacy of these Guidelines and recommend any proposed changes to the Board for approval.